

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Bill Hanley on June 19, 2006

DATED: June 20, 2006

On June 19, 2006, Michael Schachter and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Bill Hanley from the City of San Diego Metropolitan Wastewater Department ("MWWD") by telephone. Johnny Giang and Thomas Wang from KPMG also participated in the interview. Mr. Hanley was not represented by counsel.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Bill Hanley, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

"Inflow Sources"

Mr. Hanley was read Exhibit 1, a February 14, 2002 email from Bill Hanley to Dennis Kahlie (Utilities Finance Administrator) re: "Revenue Program Guidelines." Mr. Schachter asked Mr. Hanley to explain Mr. Kahlie's comment in the email, "While you're at it, you might want to read the section on the sewer use ordinance, which requires that we prohibit any new connections from 'inflow sources'...another great reason to give that \$410 million back." Mr. Hanley replied that he recalled discussions concerning the fact that the City needed to properly implement strength-based billing as required by the conditions in the grants and loans and Mr. Kahlie's statement had to do with "some law that says you can't have a dual system." Mr. Hanley explained that a dual system meant one system that dealt with both wastewater and storm water. Mr. Schachter asked Mr. Hanley whether storm water flowed into the wastewater treatment facilities in San Diego. Mr. Hanley responded that San Diego had separate systems for handling storm water and wastewater. He noted that there were some specific areas where interceptors "take the first flush" during a storm water situation and he believed that the first flush flowed into the sewer system. Mr. Schachter asked Mr. Hanley whether having the first flush of storm water flow into the sewer system was appropriate. Mr. Hanley replied that it was his understanding that the pre-existing system was appropriate because it was grandfathered in but that under the grant conditions, new connections that would allow storm water to flow into the sewer system were inappropriate. Mr. Schachter asked Mr. Hanley if he was aware of any new connections and Mr. Hanley replied he was not. Mr. Schachter asked Mr. Hanley who would know more about inflow sources. Mr. Hanley recommended we speak with Scott Tulloch (Director of the Metropolitan Wastewater Department) and David Schlesinger (former Director of the Metropolitan Wastewater Department).

Mr. Hanley said that he recalled there was some concern about pollution and also a discussion about the point at which water becomes wastewater. He said that there was a push under federal law to keep the storm water and wastewater systems separate. He noted that the East Coast tended to have combined systems for wastewater and storm water. He recalled that there was some conversation concerning whether to combine the storm water and wastewater systems in San Diego but did not recall whether there was concern regarding whether the State would give the City problems about doing so. Mr. Schachter asked Mr. Hanley if there was concern that, if the City were to use inflow sources, it could jeopardize the grant and loan funds. Mr. Hanley replied that it may have been a prospective issue and there may have been discussion concerning whether the City should include storm water in the wastewater system. Mr. Schachter asked Mr. Hanley what he meant by the comment in the email, "You're nothing but good news." Mr. Hanley said that the City was having issues with strength-based billing and the State and the inflow sources issue was another issue "to argue with the State." He said he wanted to have a good relationship with the State and did not want to bother the State with "ideas that wouldn't fly."

Sewer Bonds

Mr. Schachter asked Mr. Hanley if he was aware of any plans to issue sewer revenue bonds, or any concerns about a challenge to the validity of such bonds, before the January 29, 2002 closed session. Mr. Hanley replied that there were four issuances of bonds: 1993, 1995, 1997 and 1999, totaling \$1.2 billion. He said that every twenty-four months, the Metropolitan Wastewater Department would watch its cash flow and the execution of projects. He did not recall an issue in January 2002 regarding issuing bonds. Mr. Schachter asked Mr. Hanley if he recalled any issues regarding reimbursement. Mr. Hanley replied that he did not.

Schedule of System Obligations

Mr. Hanley was read Exhibit 2, an August 1, 2002 email from Bill Hanley to Dennis Kahlie and Eric Adachi (Rate Analyst, Supervising Economist, MWWD) re: "Schedule of System Obligations." Mr. Schachter asked Mr. Hanley what Mr. Kahlie was referring to in his statement, "When all we've got to look forward to is two balls in a vise, we don't feel that a warp speed effort is warranted." Mr. Hanley did not recall.

Conclusion

Mr. Schachter told Mr. Hanley to contact us if he recalled any new information in the future.

WF&G

EXHIBIT 1

158773

Email message text

Object type: [GW.MESSAGE.MAIL]

Item Source: [Received]

Message ID: [416BE3F7.Demo-dom.Demo-PO.100.1357474.1.27B.1]

From: [Bill Hanley]

To: []

Subject: [Re: Revenue Program Guidelines]

Creation date: [2/14/2002 7:04:29 PM]

In Folder: [Sewer Cost of Service]

Attachments: None

Message: [

Kahlie - You're nothing but "good" news.

>>> Dennis Kahlie 02/14/2002 4:14:26 PM >>>

Great! While you're at it, you might want to read the section on the sewer use ordinance, which requires that we prohibit any new connections from "inflow sources". "Inflow sources" is a defined term which includes cross connections between sanitary and storm sewers, storm water, surface runoff and other stuff that certain people want to put in the sewer system - another great reason to give that \$410 million back.

- D

>>> Kelly Salt 02/14 3:56 PM >>>

Thanks Dennis. Per the closed session discussion, I am currently reviewing these issues.

>>> Dennis Kahlie 02/14/02 03:51PM >>>

The attached file includes all SRF loan program documents. The latest (2/21/96) version of the Revenue Program Guidelines is included as appendix G.

- D

]

EXHIBIT 2

269795 {

Email message text

Object type: [GW.MESSAGE.MAIL]

Item Source: [Received]

Message ID: [3D49258C.CCP.TREASURE.100.1383633.1.3588.1]

From: [Bill Hanley]

To: [;Dennis Kahlie;DKahlie.fm.cab7-9;Eric Adachi;EAdachi.Treasure.CCP]

Subject: [Re: Fwd: Schedule of System Obligations]

Creation date: [8/1/2002 12:11:53 PM]

In Folder: [InBox]

Attachments: None

Message: [

I agree, Warp speed always gives me a headache.

>>> Dennis Kahlie 08/01/2002 11:41:19 AM >>>

I'd like to send the stuff to you. More bureaucracy = more time.

Besides - When all we've got to look forward to is two balls in a vise, we don't feel that a warp speed effort is warranted.

Hee, hee, hee.

- D

>>> Bill Hanley 08/01/02 10:55AM >>>

Dennis & Eric - The State is asking for a lot more info, see attached. I need your help on this one. Do you want to respond directly or send it to me and I forward it to the State? Thanks for the help.

]